IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA
Statesboro Division

IN RE:	)	Chapter 11 Case
	)	Number 92-60675
WILLIAM M. FAIRCLOTH	)	
MARY SUE FAIRCLOTH	)	
	)	
Debtors	)	FILED
	)	at 3 O'clock & 59 min. P.M.
	)	Date: 8-19-93
WILLIAM M. FAIRCLOTH	)	
MARY SUE FAIRCLOTH	)	
	)	
Plaintiffs	)	
	)	
vs.	)	Adversary Proceeding
	)	Number 93-6010
SECURITY LEASING COMPANY, INC.	)	
	)	
Defendant	)	

ORDER

In response to a motion for relief from the stay of 11 U.S.C. §362(a) brought by Security Leasing Co., Inc. ("Security Leasing"), the debtors, William and Mary Sue Faircloth, filed a counterclaim alleging that Security Leasing had violated the stay of §362(a) and that certain "leases" between Security Leasing and the debtors are security agreements and not leases. Because of the nature of these allegations and the recovery sought by the debtors, their counterclaim is treated as an adversary proceeding. See Bankruptcy Rule 7001(1),(2) & (9). In the matter now before me, the parties seek a ruling as to the true nature of their agreements, including the applicable law governing that determination. Based on the evidence presented and relevant legal authority, I make the following findings of fact and conclusions of law.

FINDINGS OF FACT

The debtors operate a trucking business located in Swainsboro,

Georgia. In 1989 and 1991, the debtors entered into a series of agreements to "lease" certain trucks from Security Leasing, a business located in Greenville, South Carolina.

On February 24, 1989 the debtors entered into a "Lease Agreement" with Security Leasing for a 1989 WHITE/GMC truck serial number 4VlWDBCH7KN616264 ("616264") for a term of 48 months with payments of One Thousand Eight Hundred Eighty and 54/100 ($1,880.54) Dollars each month. A second agreement was entered into with Security Leasing by the debtors' son-in-law, Michael Atkinson, on March 9, 1989 for an additional truck, a 1989 WHITE/GMC serial number 4VlWDBCH3KN616262 ("616262"), on identical terms. Each agreement provided that it was to be construed in accordance with the statutory and common law of South Carolina. At the same time as these leases were executed, each party also entered into a separate option to purchase the "leased" truck. Both options provided that when the lease was paid-up at the end of its term, the debtors (616264) or Mr. Atkinson (616262) could either return the truck or purchase it for the sum of Sixteen Thousand Five Hundred and No/100 ($16,500.00) Dollars. By later amendment, dated February 2, 1991,

the debtors assumed Mr. Atkinson's lease and option agreement on vehicle 616262. The debtors and Security Leasing entered into a third agreement dated May 8, 1991. This agreement covered both vehicles 616262 and 616264 and although it replaced the first two agreements, it contained virtually the same terms and conditions as the previous two agreements and was consistent with the previous two agreements.[1]

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[1]The differences between the previous agreements and the third agreement are that the choice of laws covenant was eliminated in the third agreement and the term of the third agreement which began May 8, 1991 required 22 monthly payments of $1,880.54 per truck. This corresponded with the initial term under the agreement for vehicle 616262, but extended the initial term on truck 616264 by one month. Additionally, the third agreement provides:

> 19. ENTIRE AGREEMENT: this lease and any addenda referred to herein constitute

The debtors entered into a fourth lease agreement and option to purchase with Security Leasing on May 17, 1991. The truck covered by the agreement, a 1989 WHITE/GMC serial number 4V1WDBCH6KN620189 ("620189"), was to be leased for 24 months with payments of Two Thousand Two Hundred Twenty Five and No/100 ($2,225.00) Dollars per month. This fourth agreement was identical in form to the third agreement referenced above. The accompanying option agreement allowed for the debtor to purchase the truck at the end of the term for the sum of One and No/100 ($1.00) Dollars.

All agreements contained covenants relevant to the issue presented. The agreements designate debtor as the "Lessee" and Security Leasing as "Lessor". Title to the equipment remained in the lessor. The certificates of title covering all three vehicles list Security Leasing as "owner". Debtors were required to maintain insurance on the vehicles, to pay any required taxes, and to make all necessary vehicle maintenance and repairs. Finally, the debtors bore all risk of loss

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> the entire agreement of the parties hereto. No oral agreement, guaranty, promise, condition, representation, or warranty shall be binding. All prior conversations, agreements or representations related hereto and/or to the Equipment are superseded hereby, and no modification hereof shall be binding unless in writing and signed by an officer of the party to be bound.
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> 20. NO RENEWAL OR PURCHASE OPTION: lessee shall have no option to renew this lease or to purchase or otherwise acquire title to or ownership of the Equipment and shall have only the right to use the same under and subject to the terms and provisions of this lease.

In spite of the fact that there is no evidence of any subsequent separate purchase agreement for the trucks 616262 and 616264, at hearing and in briefs submitted, Security Leasing acknowledges the existence at the date of the filing of the bankruptcy petition of the purchase options for both trucks for $16,500.00 each.

of, damage to, or destruction of the equipment.

CONCLUSIONS OF LAW

In their counterclaim against Security Leasing, debtors contend that the "leases" entered into between the parties are disguised security agreements and not leases. The Bankruptcy Code defines "security agreement" as an "agreement that creates or provides for a security interest," 11 U.S.C. § 104(50), and whether a lease is actually a "security agreement" under the Bankruptcy Code depends on whether it constitutes a security interest under applicable state law. H.R.Rep. No. 595, 95th Cong., 1st Sess. 314 (1977), reprinted in 1978 U.S. Code Cong. & Admin. News 5787~, 6271. See In re National Traveler, Inc., 110 B.R. 619, 620 (Bankr. M.D. Ga. 1990).

As Georgia is the forum state, its choice of law rules govern what state law applies to the allegations set forth in the debtors' counterclaim. Klaxon Co. v. Stentor Electric Mfg. Co., 313 U.S. 487, 496, 61 S.Ct. 1020, 1021 (1941); In re Purity Ice Cream Co., 90 B.R. 183, 186 (Bankr. D.S.C. 1988). Georgia courts apply the traditional lex loci contractus rule that

> '[contracts are to be governed as to their nature, validity and interpretation by the law of the place where they were made, except where it appears from the contract itself that it is to be performed in a State other than that in which it was made, in which case . . . the laws of that sister state will be applied . . . .'

General Telephone Co. of Southwest v. Trimm, 252 Ga. 95, 311 S.E.2d 460, 461 (1984) (quoting Tillman v. Gibson, 44 Ga. App. 440, 442-43, 161 S.E. 630 (1931)). In this case, from the limited evidence before the court, it appears that the agreements were made in South Carolina. Moreover, while debtors' performance under the agreements was largely to occur in the state of Georgia, payments under the contract were to be made at Security Leasing's place of business in

South Carolina. I find that South Carolina law would apply under Georgia's lex loci contractus rule and is therefore controlling in the determination of whether the agreements are leases or security agreements.

In distinguishing between a lease and a security interest, the South Carolina Code provides that

> "[s]ecurity interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. . . . [w]hether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security. (emphasis added).

S.C. Code Ann. § 36-1-201(37) (Law. Co-op. Supp. 1992). Although the agreements in question are designated as "leases" with the parties referred to as "lessor" and "lessee" throughout, the parties' characterization of the agreement is not determinative. In re Merritt Dredging Co., 839 F.2d 203, 209 (4th Cir.), cert. denied, 487 U.S. 1236, 108 S.Ct. 2904 (1988).[2] As

stated by the United States Court of Appeals for the Fourth Circuit:

> Whether a putative lease actually represents a security interest depends primarily upon the intent of the parties. S.C. Code 36-1201(37). The intent of the parties must be measured by the application of an objective standard to the facts of each case. 1 G. Gilmore, Security Interests in Personal Property 11.2 at 338 (1965).

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[2]Decisions interpreting South Carolina law on this issue are limited. See In re Merritt Dredging Co., supra and In re Wall Tire Distributors. Inc., 116 B.R. 867 (Bankr. M.D. Ga. 1990). However, the provision at issue is derived from the Uniform Commercial Code and courts have adopted a fairly uniform analysis. See James White & Robert Summers, Uniform Commercial Code 21-3 (3d ed. 1988). Moreover, both Georgia and South Carolina apply the same basic economic realities test in deciding this issue. For a thorough discussion of Georgia's approach, see Wood v. General Electric Credit Auto Lease Inc., 187 Ga. App. 57, 369 S.E.2d 334 (1988).

In re Merritt Dredging Co., 839 F.2d at 208-209.

The agreements required that debtors maintain insurance on the vehicles, pay all taxes and make all necessary vehicle maintenance and repairs. Debtors bore all risk of loss or damage to the equipment. These provisions place on debtors several of the incidents of ownership and tend to indicate the parties intended the agreements as conditional sales. Id. at 210. These factors, however are not conclusive as to the nature of the agreement.

The best test of determining the interests created by these agreements is to look at "'the true relationships and economic realities created by the agreement."' Id. at 209 (quoting Sight & Sound of Ohio, Inc. v. Wright, 36 B.R. 885, 889 (S.D. Ohio 1983)). In this case, debtor finally entered into two vehicle "lease agreements" with separate purchase options for the "leased" vehicles. See note 1 supra. The option for vehicle 620189 allowed debtors to purchase the vehicle at the end of the lease term when

all monthly payments had been made in full for the sum of One and 00/100 ($1.00) Dollars. Under the South Carolina Code, a lease that contains an option to purchase on compliance with the lease terms for no additional consideration or for nominal consideration is one intended for security. See S.C. Code Ann. §36-1-201(37)(b) supra. One dollar is nominal consideration and accordingly, the agreement for vehicle 620189 is a security agreement.

The option agreements for vehicles 616262 and 616264lallow debtors to purchase those vehicles for a sum of Sixteen Thousand Five Hundred and 00/100 ($16,500.00) Dollars each. Whether these options indicate the parties' agreements are true leases or security agreements depends on whether the debtors have acquired substantial equity in the vehicles which would be lost if they failed to exercise the option. In re Merritt Dredging Co., 839 F.2d at 210.

This determination is made by comparing the option price with the market

value of the vehicle at the time the option is to be exercised. In re Wall Tire Distributors Inc., 116 B.R. 867, 870 (Bankr. M.D. Ga 1990). If the option price is substantially less than the vehicle's market value, an equity buildup is indicated and the agreement should be considered a security agreement and not a lease. See White & Summers, supra, at 933; Woods v. General Electric Credit Auto Lease. Inc., 187 Ga. App. 57, 369 S.E.2d 334 (1988). However, no "bright line" percentage of market value should be established as determinative of whether the option price is to be

considered nominal. By example, an option price of 10% of the market value of the equipment at the end of the lease has been found to be nominal, Peco Inc. v. Hartbauer Tool & Die Co., 500 P.2d 708, 710 (Or. 1972), while an option price of 50% of the equipment's value was deemed to be more than nominal. In re Marhoefer ~Packing Co., 674 F.2d 1139, 1144 (7th Cir. 1982) ($9,968 option price).

The evidence before the court as to the value of trucks 616262 and 616264 is conflicting. The testimonies of the debtor, William Faircloth, and William McDaniel, vice president of Security Leasing, place the value of each truck between Twenty Thousand and 00/100 ($20,000.00) Dollars and Forty Thousand and 00/000 ($40,000.00) Dollars. Under the analysis enunciated above, while a Sixteen Thousand Five Hundred and 00/100 ($16,500.00) Dollars option price might be deemed nominal in relation to a Forty Thousand and 00/100 ($40,000.00) Dollar truck market value, it is more than nominal in relation to a Twenty Thousand and 00/100 ($20,000.00) market value. Therefore, the limited evidence of intent of the parties is determinative. Mr. McDaniel testified that the purchase option price was usually based on market value; however, this assertion could not possibly hold true as to truck 620189 under the fourth referenced agreement with a one dollar purchase option. The intent of the parties under each agreement can better be determined by considering both final agreements. The option prices of trucks 616262 and 616264 are for a considerable sum when compared to the

One an 00/100 ($1.00) Dollars purchase option for truck 620189. The parties intended for the purchase option prices on trucks 616262 and 616264 to reflect those trucks market value at the end of the lease term. The agreement for trucks 616262 and 616264 is a true lease.

It is therefore ORDERED that the debtors comply with the provisions of 11 U.S.C. §365 assuming or rejecting the lease agreement dated May 8, 1991 for trucks 616264 and 616262 within thirty (30) days of the date of this order by amending their proposed disclosure statement and plan to reflect the election; and

further ORDERED that the agreement dated May 19, 1991 for vehicle 620189 is a security agreement wherein Security Leasing retains a security interest in the vehicle; and

further ORDERED that the hearing on the debtors' disclosure statement is continued pending filing of a recast amended plan and disclosure statement; and

further ORDERED that a status conference on the motion for relief from stay and debtors' counterclaims for stay violation shall be held September 9, 1993 at 10:00 a.m., Municipal Courtroom, Statesboro Police Department, Grady Street, Statesboro, Georgia.

JOHN S. DALIS
UNITED STATES BANKRUPTCY JUDGE

Dated at Augusta, Georgia
this 19th day of August, 1993.